

PHD Policy Paper-IV

July 2006

Indian Industry

Concerns, issues and challenges

Bibek Debroy
Amir Ullah Khan
Sameer Bhardwaj



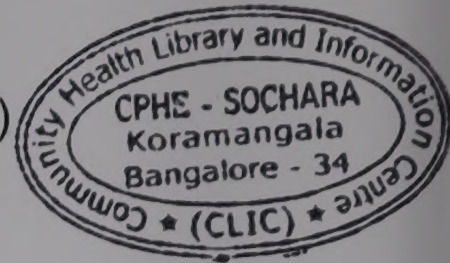
PHDCCI
www.phdcci.in

12847

CLIC - CPH

PHD PUBLICATIONS

PHD POLICY PAPER No. I

NORTH INDIAN COMMON ECONOMY (NICE)
Removal of Inter State Trade Barriers

This research paper highlights the impediments to free flow of trade amongst the states in the north and the desirability to make optimum use of natural resources of power and water for the common benefit of people in the region. The policy paper focuses on disparities in the rates of state VAT on various commodities in spite of the consensus amongst the states to adopt common rates of VAT. A reference has also been made to the disparities in taxation relating to tourism, agri-produce and transportation with specific examples. Power sector reforms are also included.

PHD POLICY PAPER No. II

The South Asia Free Trade Agreement (SAFTA)
with a focus on india-Pakistan Trade

This paper analyzes the internal trade between the South Asian Free Trade Agreement (SAFTA) members (India, Pakistan, Bangladesh, Nepal, Bhutan, Sri Lanka and Maldives). The trade between India, Pakistan and Afghanistan has examined separately. The paper concludes by suggesting the way forward and implementation of the SAFTA agreement.

PHD POLICY PAPER No. III

Indian Education Sector
Growth and Challenges

This paper analyzes the development of the education sector since independence. It focuses on government, vocational and technical education. The question where do we want to liberalization of education sector all of some policy options for the government providers in the country.

or since
higher,
answer
ario and
ggesting
ducation

SOCHARA
Community Health
Library and Information Centre (CLIC)
Centre for Public Health and Equity
No. 27, 1st Floor, 6th Cross, 1st Main,
1st Block, Koramangala, Bengaluru - 34
Tel : 080 - 41280009
email : clic@sochara.org / cphe@sochara.org
www.sochara.org

Rs. 250/-

Contents

Introduction	1
The Lagacy	5
Labour and Employment	8
Labour Laws	10
Constraints Faced by the Manufacturing Sector	12
Import Duties	13
Domestic Indirect Taxes	16
Export Incentives/Export Subsidies	20
FDI and Procedures	22
Selected Economic indicators	24

Indian Industry: Concerns, Issues And Challenges

Introduction

Indian manufacturing sector now faces new challenges that a new economic order guided by the dictates of liberalisation and globalization throws up. The present decade is the decade of the growth of the Indian multinationals. Many Indian business houses are now benchmarking themselves against the best in the world. Quality and efficiency seem to be the new mantra guiding the Indian manufacturing sector the buzz words being cost and quality competitiveness, financial restructuring, and brand equity. Though in the global consumer markets there may still be a conspicuous absence of the 'Made in India' brand, the 'Made in India' brand has carved a niche for itself and gained widespread acceptance in the intermediate product segment within manufacturing. India is fast emerging as a major manufacturing destination of industrial products and intermediate goods which are then assembled into final, end products.

What is remarkable is the change in the attitude of the Indian business houses over the last 15 years. Today, the Indian companies do not usually look up to the government for protection, support and subsidy. There is a renewed confidence in the business groups to face the challenges of the changing world on their own inherent strengths and core competencies. Indian Industry today is poised for growth having emerged out of an inward looking controlled atmosphere and emboldened by competition domestically and from overseas. It has successfully insulated itself from the uncertain and undecided political atmosphere that it works with. In this paper, we look at what constrains growth in the industrial sector and what could be done to quickly take the sector forward.

Defining Manufacturing

The basic classification of all economic activities is the UN system's International Standard Industrial Classification (ISIC).¹ At the 2-digit level, these are also the classifications followed by the CSO (Central Statistical Organization). Section D constitutes manufacturing in the industrial classification and the 2-digit codes and descriptions (common to both ISIC and CSO) are given in the table below. This then constitutes the definition of manufacturing, both for cross-country comparisons and for Indian data. What should be noted is that some of these categories are sometimes not included in data on manufacturing. Examples are codes 22, 36 and 37.

ISIC 2-digit code	ISIC description
15	Manufacture of food products and beverages
16	Manufacture of tobacco products
17	Manufacture of textiles
18	Manufacture of wearing apparel; dressing and dyeing of fur
19	Tanning and dressing of leather; manufacture of luggage, handbags, saddlery, harness and footwear
20	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials
21	Manufacture of paper and paper products
22	Publishing, printing and reproduction of recorded media
23	Manufacture of coke, refined petroleum products and nuclear fuel
24	Manufacture of chemicals and chemical products
25	Manufacture of rubber and plastics products
26	Manufacture of other non-metallic mineral products
27	Manufacture of basic metals
28	Manufacture of fabricated metal products, except machinery and equipment
29	Manufacture of machinery and equipment n.e.c.
30	Manufacture of office, accounting and computing machinery
31	Manufacture of electrical machinery and apparatus n.e.c.
32	Manufacture of radio, television and communication equipment and apparatus
33	Manufacture of medical, precision and optical instruments, watches and clocks
34	Manufacture of motor vehicles, trailers and semi-trailers
35	Manufacture of other transport equipment
36	Manufacture of furniture; manufacturing n.e.c.
37	Recycling

1. Revision 3.1. This is not identical with the North American Industrial Classification System (NAICS) used in the CII-McKinsey study, although difference surface at levels of disaggregation far beyond the 2-digit level.

In India, the Central Statistical Organisation's data collection exercises presents interesting problems. The entire manufacturing activities are classified into two broad sectors, viz., manufacturing - 'registered' and 'unregistered'. The registered manufacturing sector covers all factories covered under sections 2m (i) and 2m (ii) of the Indian Factories Act (IFA), 1948 which respectively refers to the factories employing 10 or more workers and using power or those employing 20 or more workers but not using power on any day of the preceding 12 months and bidi and cigar establishments registered under Bidi and Cigar Workers (Condition of Employment) Act, 1966 and employing 10 or more workers using power or 20 or more workers and not using power."² Indeed, factories where a manufacturing process is not carried on are excluded.

The 'manufacturing process' is defined as any process for (i) making, altering, repairing, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal; (ii) pumping oil, water, sewage or any substance; (iii) generating, transforming or transmitting power; (iv) composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; (v) constructing, reconstructing, repairing, refitting, finishing or breaking up of ships or vessels; (vi) preserving or storing any article in cold storage. Factories registered under IFA but not engaged in manufacturing activities are excluded. There is thus a dichotomy between registered manufacturing and unregistered manufacturing. For registered manufacturing, data are collected annually through the Annual Survey of Industries (ASI). This is part survey (sample) and part census. Unregistered manufacturing, which also includes own account enterprises, is covered much less frequently, typically, once every five years:

In 2001, there was a fairly serious critique of the entire Indian statistical system.³ Although the criticisms were greater for other sectors of the economy, manufacturing data were also criticized in all the four components of ASI, unregistered manufacturing, small-scale industries (SSI) and the index of industrial production (IIP). For instance, other than time lags and sampling and non-sampling errors, the ASI includes units that shouldn't be included (they have closed down) and excludes units that should be included. Different databases of unregistered (census or survey) manufacturing vary widely, perhaps understandable, because differing concepts and definitions are used. This is compounded by lack of adequate data on SSI and unorganized traditional industries (village and small industries). The National Statistical Commission's report was written much before data on the 3rd Census of SSIs, undertaken in 2001-02, became available. But this 3rd Census illustrates the kinds of problems that arise. After the 3rd Census, for 2001-02, Economic Survey 2003-04 gives the following figures for the SSI sector registered units 1.375 million, unregistered units 9.146 million, total units 10.521 million, total production in current prices Rs 2,82,270 crores and employment 24.909 million. But before the 3rd Census results became available, Economic Survey 2002-03 gave the following figures for the SSI

Share of the Manufacturing sector in GDP (%)

India	15.8 ⁴
Argentina	23.9
Brazil	11.4 ⁵
Chile	15.8 ⁶
Mexico	18.1
South Africa	18.9
China	44.5
Indonesia	25.0
South Korea	23.7
Philippines	22.9
Thailand	34.2
Malaysia	31.1
Pakistan	16.2
Sri Lanka	15.5
Bangladesh	15.8

2. NAS Sources and Methods, CSO, 1989.

3. Report of the National Statistical Commission, August 2001.

4. India's share was 16.3% in 1983.

5. Brazil's share was 33.2% in 1983.

6. Chile's share was 21.2% in 1983.

Sector, also for 2001-02 registered units 2.731 million, unregistered units 0.711 million, total units 3.442 million, total production in current prices Rs 6,90,316 crores and employment 19.223 million. The discrepancies are remarkable. Finally, other than the problem that the index of industrial production (IIP) represents only 80% of manufacturing, there are problems associated with low response rates, small samples, unsatisfactory weights and non-representation of the unorganized sector. As a generalization, manufacturing data are therefore somewhat satisfactory for registered manufacturing and extremely unsatisfactory for everything else.

It is possible to play around with numbers to work out future scenarios. Between 1993-94 and 2003-04, the annual average real rates of growth have been 2.66% for agriculture (excluding mining), 5.41% for non-manufacturing industry, 6.92% for manufacturing and 8.03% for services, yielding a real GDP growth rate of 6.24%. As was mentioned earlier, the rough sectoral contributions to GDP are 22% for agriculture and allied activities (excluding mining and quarrying), 51% for services and 27% for industry. Of the 27% industrial contribution, around 9% is non-manufacturing industry (including mining and quarrying). The manufacturing contribution proper is around 18% of GDP. What does it mean to say that manufacturing's share of GDP should be 30%? At one level, one is arguing that historically, manufacturing could have done better and compared to other countries, there is no reason why the share today should not have been 30%, as compared to 8%. This is a valid point to make. But at another level, one is arguing that there should be a game plan to take manufacturing's share to 30%. This is more questionable, more so if it is articulated in terms of manufacturing's share, as opposed to industry's share.

Manufacturing's share is a function not only of manufacturing growth, but also of growths in the other sectors. For instance, there is no reason why service sector growth should slow down from that historical trend of 8.03%. Indeed, in the next twenty years, the service sector share in GDP should inch up towards 60%. Nor is there any particular reason why non-manufacturing industrial growth should slow down. And non-manufacturing industry will continue to account for at least 10% of GDP. While agriculture's share in GDP ought to progressively decline, no reasonable projection will assume an agricultural contribution of less than 10% in the next twenty years. That leaves a manufacturing contribution to GDP of 20% and no more. Anything more than a 20 or 25% contribution of manufacturing to GDP is extremely implausible. As the historical trend shows, it has taken more than 20 years to increase the manufacturing share by five percentage points to around 18%. Another five percentage points will take another 20 plus years, in a business-as-usual kind of scenario. In a non business-as-usual kind of scenario, the transition will at best be accelerated. If the target is expressed as manufacturing's share in GDP, and the timeframe is the next 10 years, one should at best hope for something like a 23% share in 2015. Not 30%.⁷

Targets are better articulated in terms of manufacturing's growth alone, independent of growth rates in non-manufacturing sectors. Over the last ten years, the trend rate of growth in manufacturing has been 6.9%, say 7%. This is the somewhat pessimistic, business-as-usual kind of target. An aspirational target can be real growth of 9%.⁸ This is probably the most likely scenario. A more optimistic target, requiring substantive reforms, will be a growth target of something like 12%. Given manufacturing's present share of 18% of GDP, the difference between 7% and 12% translates into 0.9% additional incremental GDP growth. And the difference between 7% and 9% translates into 0.36% additional incremental GDP growth. As was mentioned earlier, if the employment elasticity increases to 0.59, 9% growth means 2.2 million new jobs a year and 12% growth means 2.9 million new jobs a year. These are figures on direct job creation. Figures on indirect jobs created, as a result of multiplier effects, are impossible to compute.⁹

An overall or aggregate target of 12% growth, or even 9%, is too aggregated for any policy thrust. This needs to be decomposed or disaggregated according to manufacturing sub-sectors. For instance, in the index of industrial production (IIP), there are 17 industry groups at the 2-digit level of classification.¹⁰ This is indicated in the table below and is based on the National Industrial Classification (NIC) and differs from the ISIC 2-digit codes mentioned earlier.

7. The CII-McKinsey aspiration is 18-21% share of GDP by 2015.

8. CII-McKinsey has an aspirational target of 8-9%, decomposed into domestic growth of 7-8% and export growth of 15-17%.

9. Although CII-McKinsey suggest two to three times the direct figure.

10. As was mentioned earlier, IIP only covers 80% of manufacturing.

NIC 2-digit code	Description	Weight in IIP (%)	Possible target growth	Contribution to (%) manufacturing growth
20-21	Food products	9.1	6%	.00546
22	Beverages, tobacco & related products	2.4	10%	.0024
23	Cotton textiles	5.5	8%	.0044
24	Wool, silk & man-made fibre textiles	2.3	4%	.00088
25	Jute & other vegetable fibre textiles (except cotton)	0.6	1%	.00006
26	Textile products (including wearing apparel)	2.5	14%	.0035
27	Wood & wood products, furniture & fixtures	2.7	10%	.0027
28	Paper & paper products & printing, publishing & allied industries	2.7	20%	.0054
29	Leather & leather & fur products	1.1	3%	.00033
30	Basic chemicals & chemical products (except petroleum & coal)	14.0	16%	.0224
31	Rubber, plastic, petroleum & coal	5.7	7%	.00385
32	Non-metallic mineral products	4.4	5%	.0022
33	Basic metal & alloy industries	7.5	12%	.009
34	Metal products & parts, except machinery & equipment	2.8	7%	.00196
35-36	Machinery & equipment, other than transport equipment	9.6	20%	.0192
37	Transport equipment & parts	4.0	20%	.008
38	Other manufacturing industries	2.6	20%	.0052
Total		100.0		.09694

There are two broad ways of identifying sub-sectors for a thrust and it needs to be highlighted that these two methods of identification are not always compatible. The first criterion is in terms of possible employment generation. For instance, if one were to use this yardstick, one would probably pick codes 20-21 through 29 from the above list. The CMP itself mentions some manufacturing industries food processing, textiles and garments, engineering, consumer goods, pharmaceuticals, capital goods, leather and IT hardware. Although this list is merely illustrative, there is probably an implicit employment criterion in this identification. More explicitly, the budget for 2005-06 mentions the employment criterion and singles out textiles and garments, food processing and IT. To quote from the budget speech, "Sectors with potential for generating employment will receive the highest attention of the Government." How this can be operationalised is a separate matter and we will return to that later. The second possible identification of thrust areas is not in terms of employment, but in terms of the weights different sub-sectors have in overall manufacturing growth. These weights are given in the table above. For instance, as the table shows, basic chemicals (code 30) have a large weight, although its employment potential might not be that large. In general, codes 30 through 37 probably have low employment potentials. The manufacturing sector has performed relatively well in 2003-04 and 2004-05, especially the latter, although nowhere near as well as in 1995-96. Based on the performance in 2003-04 and 2005-06, the table above also shows reasonable growth targets for the 17 industry groups. These are not unnecessarily optimistic. Rather, they reflect an aspirational target. As the table shows, 10% growth in manufacturing is within the realm of possibility. Provided the growth is uniform across sectors.

11. Revision 3.1. This is not identical with the North American Industrial Classification System (NAICS) used in the CII-McKinsey study, although difference surface at levels of disaggregation far beyond the 2-digit level.

The Lagacy

In modern India, policy objectives have usually been directed towards equity and a balanced growth of various productive sectors of the economy with the haloed attempts at growth with social development through justice and equality. However, medieval India was characterised by a lack of policy. Villages existed as little republics with almost no contact with the rest of world. Local kings or rajas collected revenue in various forms and this funded the state treasury that looked after the well-being of the king, his staff and sustained the meager administrative structure. Towns, on the other hand, relied primarily on trade that passed by, and each town specialised in a few commodities.

India came under the British parliament's rule in 1858 and then followed a policy regime that was a new economic system rooted in colonialism. The focus was on generating surpluses through stringent land revenue collections. Following the industrial revolution, India became increasingly a source for raw material and a market for manufactured goods. Investment was largely on plantations, transportation and mining. Food grains were the mainstay of Indian agriculture but productivity remained stagnant.¹² Non-food grain production grew handsomely. Tea, coffee, sugarcane and spices saw a healthy growth in exports. Railways and electricity reached a large part of the country. However, infrastructure was far too deficient to harness any benefits for the economy.

Before the Industrial Revolution, India was extremely primitive industrially. A major part of India, with the exception of some coastal towns particularly on the western coast, lacked administrative and legal conditions necessary for industrial development in the sixteenth and seventeenth centuries. The exploitative policies of the State largely accounted for this state of affairs. But a change started before the end of the seventeenth century and by the end of the eighteenth century, India had attained a significant degree of industrial development. Though spinning and weaving were the national industries even up to the commencement of the nineteenth century, a variety of other industries including building, lime manufacturing, leather works, copper, iron works, ship-building, sugar and salt manufacture and indigo manufacture flourished in India. In fact, around 1800, India's economic development was almost at par with that of several European countries which are considered industrially advanced now.

The population was engaged mostly in agriculture. In their spare time, agriculturists and the members of their families engaged themselves in the manufacture of goods, chiefly cloth. Some people were wholly engaged in manufacture of goods, but this manufacture depended only on manual labour and on the special skill of the workers. Self-sufficiency was the rule, so that the produce and manufactured articles of a locality were sold within a small local area, and there was little trade except in costly articles.

Following the Industrial Revolution, India's manufacturing industries particularly handmade textiles had to face stiff competition from the machine-made goods of Lancashire, Sheffield and other centres of British industry. This was backed by the commercial policies of the Indian Government which were unfavourable to the Indian economy. For example, during the nineteenth century, the Government not only did not start an iron and steel industry in India itself, but it also refused permission to J. N. Tata, to manufacture iron in the then Central Provinces in the 1880s.

Only towards the close of the nineteenth century did modern large-scale industry made a beginning in this country. The British merchants became managing agents and started establishing new industries. After the First World War, there was a change in the economic policy of the government. This, coupled with the enterprise shown by such pioneers as J. N. Tata, Mukerjee, Walchand Hirachand, brought about the development of industries like steel, metal fabricating and ship-building, besides cement, sugar, matches and, of course, textiles. But it must be noted that even with all the courage and enterprise shown by the entrepreneurs in introducing the factory system of production in India, the factory establishments accounted for only 6.6 per cent of the total national income in 1948-49 after the independence.

12. The compound annual growth rate in food grain production has been in the range of 1.7 per cent in the fifties to 3.5 per cent in the eighties and now seems to be going back to the old pattern where it fails to match the rate of population growth.

All these factors weighed heavily on policy makers as they sat together to evolve an economic and industrial policy for independent India. The first casualty was free enterprise. It was felt that in an economy where infrastructure facilities were poor, per-capita income and the levels of savings extremely low and great inequality in the distribution of income, free enterprise could not be allowed. Exports, seen as a drain of resources, were considered dangerous and the idea of free trade ridiculous. Foreign investment was and continues to be considered synonymous with foreign domination, and hence was ruled out. But foreign exchange reserves had to be built to pay for essential imports and that is why it was felt that it would be easier and safer to take foreign loans.

Domestically it was believed that rapid industrialisation was desirable with an emphasis on capital goods and heavy industries. This would in effect spur growth in agriculture, employment generation and the service sector. Underlying all these was the belief that the State must play an active and central role in the development process through the five-year plan model. Out of this thinking emerged India's post-independent economic policies – a course of planned economic development that would ensure rapid growth in production with a view to achieving a higher level of national and per capita income, full-employment and a reduction of inequalities in income and wealth. The Socialistic pattern of society, with a democratic framework would pave the way for and justice and absence of exploitation.

The scene was dismal immediately after independence. In 1950-51, the population of the country stood at 361 million, the literacy rate was a poor 18%, per capita income (at 1980-81 prices) was Rs 1,127, only 3000 villages were electrified, and the banking sector boasted of a little more than 5000 branches. It is in this backdrop that India's political economy sought to define itself. And chose the path of import substitution, foreign exchange controls, and public sector led growth and a savings oriented economy. The fiscal policy aimed at increasing tax revenue and handling of debt servicing. The monetary and credit policy orchestrated under the aegis of the Reserve Bank of India worked its way through crises by way of large-scale bank nationalisation and a tightly controlled credit policy. The pricing policy was based on administered prices, cost plus pricing and discriminatory and dual pricing. The industrial policy was founded on the principles of licensing, clearances and a centralised investment policy. And the labour and employment policy was aimed at securing employment in the organized labour, provisioning of social security for the labour force within the organised sector and through monopolised government-owned insurance schemes.

In the pre-British period, the advanced sectors of the Indian economy were agriculture and manufacturing sectors. The 1871 census showed that 56 per cent of adult male population was engaged in agriculture. In manufacturing, technical skills in spinning weaving, dyeing, gold, silver, handicrafts, and perfumes were predominant. However, trade suffered as the communication systems were poor and transportation meagre. Yet, there was enough evidence of external trade. India enjoyed surpluses and received gold and silver. There were virtually no roads but shipping was of a very high standard. Individuals and families operated banks and the main instrument of credit was the 'Hundi'. All in all, a predominance of rural life, an economy that was almost entirely rural in its simple division of labour and an emphasis on hereditary skills. A very small urban population was found in a few centres.

The British period evidenced large scale stagnation and India became an underdeveloped economy. This downward slide came about as a result of the following major factors. There was a reduction in the per capita income during the British rule. There were low living levels with a high birth rate of 45 per thousand, considered the biological maximum rate. Death rate went up to 47 per thousand in 1941 and the literacy rate of only 17 per cent. There was low growth in national income, coupled with little addition to stock of real capital. Net investment was low. Capital stock in fact declined due to the Second World War. Partition led to further depletion as the fertile lands in Punjab were partitioned and 23 per cent of territory went to Pakistan with about 18 per cent of population. The British had encouraged feudal relations and landlord tenant relationships. As a result, the number of workers in agriculture went up from 74 per cent in 1881 to 76 per cent in 1931. In manufacturing, employment reduced from 18 per cent in 1881 to 15 per cent in 1931.

13. The savings rate in India, as a result of the push for more, increased from about 10 per cent in 1950 to about 24 lately. The domestic saving rate was even higher as foreign assistance came in. However, growth rates could never correspond with this increase. Bhagwati, Jagdish and Srinivasan, T. N., *India's Economic Reforms*, 1993

The causes of stagnation were many. Meagre resources, low levels of technology and anti-growth attitudes,¹⁴ population pressure,¹⁵ state apparatus used in the interest of British industry and against Indian economy with heavy import duties in Britain, high excise duties in India, and a lopsided Government procurement policy. On top of all this the country was squeezed of its surpluses from the budget and the foreign trade sector several payments for which there were no returns. The drain is estimated to be at least 2 to 3 per cent of national income in the period 1757 - 1939.

Nehru was anti-authoritarian and had rejected Marxism. He had also rejected Gandhi's concept of a non-industrial society rooted in rural democracies, because he thought that such a system would do nothing to raise people from their poverty. Nehru believed in a strong public sector and envisioned mighty industrial plants as the temples of modern India. He made economic self-reliance a national cause. Of the top 50 Indian companies in 1939, 32 were British. Not one of them has survived today. Nehru presided over the first three five-year plans. The annual growth rate averaged more than 4 percent between the start of the 1950s and 1964. In the First plan, not much could be done to expand industrial capacity. The First Plan laid greater stress on agriculture, irrigation and power. Industry received only 8.4 per cent of the total budgeted outlay of INR 206.90 million. But starting from the Second plan, development of large industrial sector had taken about 20 per cent of the total Plan outlay in successive Plans. Together with private sector industrial investment, this has succeeded in diversifying India's industrial structure and in reducing dependence on industrial imports. From all accounts, the government made a determined bid to industrialise the country at as rapid a pace as possible.

Small and cottage industries using simple tools and machinery co-existed with the large-scale factory establishments. The Government realised the importance of these industries particularly from the point of view of employment opportunities offered by them. The response of the small-scale industries has been a rather mixed bag. On the one hand, the small-scale industries have worked well to generate employment by using relatively more labour-intensive technology compared to the large-scale industrial units, the small-scale industries, on the other, have not been able to withstand the test of competition without government support or subsidy.

In a rapidly liberalizing and globalizing economy, where most governments are under severe fiscal stress, support and subsidies to small-scale units has been on a decline. The economy has witnessed widespread sickness and stagnation in the small-scale sector. However, under the structural adjustment programme and the new economic policy, the government cannot continue to patronize small-scale units on the crutches of subsidy and soft-budgets. It is encouraging to note today that some small-scale industries have adopted a more enlightened and progressive attitude with regard to the calculation of costs, use and choice of technology, and protection from the government against domestic and international players.

14. Knowles, in *The economic development of the British Overseas empire*, lists these factors as religion, caste structure, etc.

15. Kinsley Davis makes an argument that the population pressure seen as the major culprit is not the main reason. The problem is not that of sheer numbers but that of economic growth not keeping up with population growth. Dadabhai Naoriji and Romesh Dutt both put the blame squarely on The British Government's colonial policy.

Labour and Employment

India possesses a comparative advantage in labour. As with every other developing country, that has always been the case. Labour is relatively more abundant than capital. In a completely integrated and globalized world, national boundaries should make no difference. Even if cross-border movements of technology and capital are relatively free, there will be restrictions on cross-border movements of labour. Integration of labour markets will only happen in niches, in selected segments. Therefore, India should be in a position to exploit its cost advantage in labour, and in natural resources, to push manufacturing growth. Nor should one forget India's strengths in science and technology and in education. These reinforce the labour cost advantage.

To this traditional labour cost advantage has been added the demographic dividend. This means that populations in developed countries are aging, whereas in developing countries, the working age population is increasing. Outsourcing to India has happened and has even figured in election debates in developed countries. But that has been for services. In the 1970s, 1980s and even the 1990s, India missed opportunities in off-shoring of manufacturing. There is no reason why that should happen in the next two decades also. One should also note a demographic shift that is taking place within India. In the next twenty years, there will be aging populations in South India and it is North India that should reap some form of a demographic dividend.

In India, unemployment data does not cause agony. The problem is more of under-employment. And there are significant variations in unemployment rates across States. For instance, unemployment rates are more than 10% in States like Kerala, Tamil Nadu and West Bengal. What is worrying is that the annual average growth in employment has slowed. While the average annual growth rate in employment was 2.89% between 1983 and 1987-88 and 2.50% between 1987-88 and 1993-94, it was 1.07% between 1993-94 and 1999-2000. This slowing down is largely because in the 1990s agriculture failed to create jobs. However, it is not pure agriculture's business to create jobs. The history of development is one of pulling people out of agriculture, into non-farm activities, into manufacturing and into services, not retaining them there. In that sense, India has witnessed a failed industrial revolution. If 10 million new jobs have to be created a year, manufacturing has a role to play.

Between 1993-94 and 1999-2000, the average annual employment growth in manufacturing was 2.58%, compared to 3.64% between 1982 to 1987-88. Employment in manufacturing was 40.79 million in 1999-2000. If manufacturing grows at 9%, with an employment elasticity of 0.33, 1.2 million jobs are created in manufacturing a year. But if the employment elasticity is 0.59, as it was between 1983 and 1987-88, with 9% manufacturing growth, 2.2 million jobs are created a year. And if manufacturing growth increases to 12%, with an elasticity of 0.59, 2.9 million jobs are created a year in manufacturing. There is a target of creating 10 million jobs a year. However, this is for the entire economy and not all of this 10 million is expected to be created in manufacturing. But manufacturing can make its contribution.

What should be of concern is the declining employment elasticity of manufacturing in the 1990s, compared to say, the 1980s. While labour market rigidities may be partly responsible, these haven't worsened in the 1990s. The answer therefore probably lies in restructuring consequent to competition, leading to shedding of surplus jobs, and even a sectoral change in manufacturing sectors that have shown relatively higher rates of growth in the 1990s. Industry has been stressing that there is a serious mismatch between the needs of the industry and the availability of skilled manpower for the manufacturing industry. If the Indian manufacturing has to grow at around 12% per year in order to support a growth of 8% of GDP, it will be necessary for the education and training system to produce at least 1.5 million technically skilled people every year. This is also the right place to mention inter-State differences. Most of the demographic dividend, in terms of new entrants into the labour force, is going to occur in central parts of India, leading eastwards. In an era of industrial licensing, manufacturing capacities could be set up in geographical areas where labour forces existed. But industrial licensing is not only impossible now, it is also undesirable. Nor will employment growth primarily happen through the public sector, and it must not be forgotten that many sick public sector units (PSUs) are precisely in these geographical regions and they will eventually be closed down. If one is to avoid tensions over a few jobs in the Railways, private sector job creation, including in manufacturing, must compensate.

This is also the right place to mention the organized versus unorganized sector dichotomy. The figures on work force and labour force given earlier were from 1999-2000, from the NSS. In 2000, the total work force is estimated to be 397.88 million. Of this, 28.15 million, or 7.07% is in the organized sector.¹⁶ The unorganized sector accounts for employment of 369.73 million, or 92.93%. There are indeed three different definitions of organized/unorganized, although they do overlap. First, there is the labour law kind of definition, the Factories Act of 1948 being the obvious example, although this only applies to "factories". Registration is required if a factory employs 20 or more people and doesn't use power or if it employs 10 or more people and uses power. Registration is equated with organized and everything else is unorganized. Second, there is a definition of small-scale industry (SSI), in terms of threshold levels of investment in plant and machinery. SSI is often equated with unorganized manufacturing. Third, there is a threshold level of turnover below which, excise doesn't have to be paid.

Excise exemption constitutes yet another definition of unorganized. However, whichever definition of unorganized/organized one uses, the organized sector accounts for less than 8% of the work force. For instance, the 369.73 million work force figure is for 1999-2000. In 2002, the work force is 397 million. And only 27.2 million is employed in the organized sector, constituting 6.9%. 93.1% or 369.6 million is employed in the unorganized sector. Of the total employment of 27.2 million in the organized sector, 18.8 million (69%) is in the public sector. Public sector employment has stagnated in the 1990s. The private sector accounts for 8.4 million employment (31%) in the organized sector. This has increased a bit in the 1990s, but only from 7.6 million in 1990 to 8.4 million in 2002. These figures are of course for total private sector employment. Private sector employment in organized sector manufacturing is 4.9 million in 2002, compared to total manufacturing employment of 40.79 million.¹⁷ Public sector employment in organized sector manufacturing is 1.4 million in 2002. Total employment in organized sector manufacturing is thus 6.3 million, 15.4% of total manufacturing employment. This organized/total ratio may be higher for manufacturing than for overall employment, but is still fairly low.

With reforms, the dichotomy between the organized and unorganized sectors should break down. The organized sector is under the purview of labour laws, which are certainly rigid. Liberalization will involve making labour market provisions in the organized sector more flexible. However, it should also be noted that the unorganized sector is completely outside the purview of most labour laws, and this includes social security. Liberalization will also involve extending protection to labour in the unorganized sector. This is indeed the thrust of the recommendations of the Second National Commission on Labour, which submitted a report in 2002.

Rural employment generation has been unsatisfactory in the India of the 1990s. Between 1993-94 and 1999-2000, the two data points for the NSS (National Sample Survey) large samples, the annual average increase in employment was 1.6%. But this had a breakup of 2.4% for urban India and 1.3% for rural India. As is fairly obvious, unemployment rates mean very little in rural India. However, in the 1990s, there has been slackening growth in agriculture and non-agricultural rural sector employment growth has failed to compensate. Inevitably, this creates a push towards migration into urban areas. Rural growth is also critical to handling the political economy of reforms, with a general impression that liberalization has thus far had a pro-urban focus and little of the benefits have percolated through to rural India. The National Common Minimum Programme (NCMP) of the government takes explicit cognizance of the rural sector. Both the pull and the push need to be neutralized. However, rural employment cannot conceivably be in the agriculture sector alone. Employment generation will have to be in rural non-farm activities and this includes rural industries, as well as rural services.

16. The savings rate in India, as a result of the push for more, increased from about 10 per cent in 1950 to about 24 lately. The domestic saving rate was even higher as foreign assistance came in. However, growth rates could never correspond with this increase. Bhagwati, Jagdish and Srinivasan, T. N., *India's Economic Reforms*, 1993

17. These figures keep changing. Economic Survey 2004-05 has a figure of 4.7 million as private sector organized employment in manufacturing in 2003, a slight decline compared to 2002.

Labour Laws

Labour law reform is usually equated with Chapter V-B of the Industrial Disputes Act (IDA), but the issues are more complicated. Subject to the caveat that labour is on the concurrent list of the Constitution, there are 45 Central Acts and 16 associated rules that deal directly with labour. There are others that indirectly deal with labour, like the Boilers Act (1923), the Collection of Statistics Act (1953), the Dangerous Machines (Regulations) Act (1983) and the Emigration Act (1983). There is thus an issue of unification and harmonization, the lack of which contributes to the inspector raj. Consider also the time span of the legislation, from the Fatal Accidents Act of 1855 to the Public Liability Insurance Act of 1991. Over a period of time, concepts and definitions have changed. So has the case law, contributing to further confusion. For example, there is lack of unanimity about definitions of wages, workman, employee, factory, industry and child labour. Reforming labour law has many dimensions and issues like reducing State intervention in industrial relations are identified with an exit policy for labour and are therefore controversial. But unification and harmonization is an issue on which there should be no lack of consensus.

From unification and harmonization, we now move on to reductions in State intervention, in areas other than industrial relations. Industrial relations will be dealt with later. The Factories Act is a good example of unnecessary government stipulations, sometimes through resultant rules and this includes provisions on over-time. The Shops and Establishments Act of 1954 is yet another example. It is no one's case that welfare provisions should not exist. But are welfare provisions enacted in 1948 or 1954 still relevant? Assuming that they are, is the present government-mandated system with a regime of inspectors the best way to achieve the objective?¹⁸ Each labour legislation has a separate inspector and visits of inspectors are not synchronized across all labour enactments.

Barring the Payment of Wages Act, where a maximum period of three years is stipulated, no other labour statute prescribes a maximum period for which records and registers must be maintained. Compliance is thus impossible and visits of inspectors result in bribery and rent-seeking. This system is not distributionally neutral as it tends to hurt the small-scale sector much more than it hurts large-scale industry. That apart, returns under various labour laws are not standardized and inspectors insist on maintenance of manual records and registers. There can be a common format for computerization of required records. There should be a single inspector for a given area. Some inspections for site and building and site plans or testing equipment can be farmed out to recognized private agencies. With the opening up of insurance, some social security provisions can be farmed out. For example, the Employees' State Insurance (ESI) Act hasn't worked at all well.

We now move on to industrial relations. The three statutes that impinge on industrial relations are the Contract Labour (Regulation and Abolition) Act, the Trade Unions Act and the Industrial Disputes Act. The Contract Labour (Regulation and Abolition) Act was never meant to prohibit contract labour. Section 10 provided the appropriate Government the discretion of prohibiting contract labour in selected areas. In fact, in the title of the act, regulation comes before abolition. Contract labour allows flexibility and permits outsourcing. However, a few court judgements have affected this flexibility. There is an argument doing the rounds that the Contract Labour (Regulation and Abolition) Act should be scrapped. This is probably facile. If the 1970 statute is scrapped, decisions on abolition of contract labour will revert from the government to industrial tribunals. To take the Factories Act as an example, industrial tribunals are likely to conclude that since canteens are mandated under Section 46 of the Factories Act, no contract labour can be employed in canteens. It seems to be a better idea to retain the 1970 act and tighten up Section 10 so that ambiguity about continuance of contract labour and absorption following abolition is removed.

18. A recent survey (Inspector Raj and Administrative Reforms Required for Indian Manufacturing) mentions an average of 37 annual inspections, with 67 inspections in some cases. In decreasing order of importance, these inspections concern environment, labour, sales tax, excise, provident fund, electricity, ESI and industrial safety and health.

Next one should mention the Trade Unions Act. As a minor point, child labour is not prohibited in India. It is only prohibited in hazardous processes. Yet, under Section 21 of the Trade Unions Act, those under fifteen are not allowed to be members of trade unions and under Section 21-A of the Trade Unions Act, those under eighteen are prevented from becoming office bearers. But more important are provisions of the Trade Unions Act that lead to multiplicity. Under Section 4 of the Trade Unions Act, any seven people can form and register a trade union and these seven people need not even be workers. There is no cap on office bearers being from outside either. Nor is there any test for representativeness of a trade union, through secret ballots or otherwise. The multiplicity problem impinges on collective bargaining because an agreement with one union is not necessarily binding on others. This is partly due to Section 18(1) of the Industrial Disputes Act, which states, "A settlement arrived at by agreement between the employer and workman otherwise than in the course of conciliation proceeding shall be binding on the parties to the agreement." It is not mandatory on others. Maharashtra and Gujarat are the only States where there are laws requiring recognition of trade unions by employers for purposes of collective bargaining. Following recommendations of the Second Labour Commission, the government has introduced amendments to the Trade Unions Act. The number of persons required for registration of a trade union will change from seven to 10 per cent of the labour force. Not more than one-third of office bearers (subject to a maximum of five) can be outsiders. And the holding of annual elections and auditing of accounts will be mandatory.

Next one moves on to the Industrial Disputes Act (IDA) and the following is a list of sections where there are problems - Section 9-A, Section 11, Section 11-A, Section 17-B, Sections 22/23 and Chapter V-B/Sections 25-K, 25-L, 25-M, 25-N and 25-O. The argument about Chapter V-B of IDA is indeed a valid one. Labour markets become artificially rigid, employers adopt artificially high capital intensity and circumvent the legislation. An employer-employee relationship ought to be in the nature of a personal contract, with an optional provision of resorting to the government in case of exploitation. However, the provisions of the Industrial Disputes Act make recourse to the government and thus to Labour Commissioners, mandatory. Given the other provisions of labour legislation, the requirement of governmental permission can be dispensed with, without adversely affecting the interests of labour. Unless this rigidity in labour markets is removed, higher growth will not necessarily translate into greater employment. What is involved is not primarily an exit policy for labour. The statute makes it impossible for companies to exit. Competition cannot function without free exit.

The NCMP (National Common Minimum Programme) states, "The UPA rejects the idea of automatic hire and fire." Everyone who is against reforming labour markets criticizes the government for trying to introduce hire and fire. Everyone who is in favour of reforming labour markets criticizes the government for not introducing hire and fire. The recently published Economic Freedom of the World 2004 is an example. Scores are out of 10 and the higher, the better. India gets an overall score of 6.3. But for flexibility in hiring and firing, the Indian score is 2.0.¹⁹ The point is that this is probably largely perceptual rather than real. And more importantly, while a consensus on Chapter V-B is being rustled up, why not amend the other sections of IDA and implement the other labour law reforms? One should also mention the Second National Commission on Labour, which submitted a report in 2002, the first National Labour Commission having been set up in 1929. If implemented, these recommendations will harmonize labour laws under five heads of industrial relations, wages, social security, safety and welfare and working conditions. While flexibility will improve in the organized labour market, there will simultaneously be better social security provisions in the unorganized one. Implementation of the latter of course remains a problem.

Before concluding this section on labour, one must also mention development of skills, in the absence of which, the demographic dividend will also fail to materialize. No one denies that skill development is important. The issue is, who will deliver these skills? The public sector driven initiative, through the Apprentices Act and ITIs (Industrial Training Institutes) has failed to deliver. The 500 ITIs, promised in the 2004-05 budget, or other forms of vocational training, must be through public-private partnerships, if not outright private sector provisioning, with training authorities delinked from certifying ones.

19. This is the Fraser Institute's economic freedom index, not the ones brought out by Freedom House or Heritage Foundation (in collaboration with Wall Street Journal).

Constraints Faced by the Manufacturing Sector

What are the constraints in pushing up manufacturing growth still further? The constraints themselves suggest the solutions. Some of the constraints are generic in the sense that they cut across all manufacturing sectors. The others are more specific and pertain to specific sectors. Since there will be other papers addressed to specific sectors, in this paper, we only concentrate on the generic problems.

At a very broad level, some indications of competitiveness can be obtained from World Competitiveness Reports. More accurately, there are two such reports Global Competitiveness Report (GCR), published by World Economic Forum²⁰ and the World Competitiveness Yearbook (WCY), published by International Institute for Management Development (IMD).²¹ The bifurcation of one initial report into two highlights problems associated with defining competitiveness. While neither report is about manufacturing competitiveness alone, manufacturing does form an integral part of the rankings.

Consider WEF's GCR first. This has a growth competitiveness index (GCI), which captures an economy's capacity to grow in the future. Using a splicing of hard data and subjective perceptions, GCI builds on three pillars of macroeconomic environment, public institutions and technology. There are thus three indices for each of these heads and the three individual indices are aggregated to derive the overall GCI. Quite often, reports about GCI are based on India's relative rank over the years. For instance, India's rank was 45th in 1996 and 55th in 2004. Being 55th means India is wedged between Uruguay (54th) and Morocco (56th). These ranks are however misleading because the number of countries ranked has changed down the years. For example, 50 countries were ranked in 1996 and 104 countries are ranked in 2004. The values of GCI are a better indication of movements than ranks. On the three pillars of macroeconomic environment, public institutions and technology, India obtains a 63rd rank on the technology index, a 52nd rank on the macroeconomic environment index and a 53rd rank on the public institutions index. In addition to the macro and medium-term focus of GCI, GCR also has a shorter term and micro business competitiveness index (BCI). India shows quite a sharp improvement on this, the rank having improved from 37th in 2000 to 30th in 2004. To quote from the 2004 version, "Another low-income country with large improvements is India, up 8 ranks, showing the benefits of increased company sophistication and strengthened clusters."

This is not the place to debate GCR vis-à-vis WCY, or even GCI vis-à-vis BCI. What is pertinent for our purposes is that companies compete. Countries or economies don't compete. However, government policies provide the environment within which companies compete. These macro policies feed into GCR's GCI through the three intermediary indices of a macroeconomic environment index, a public institutions index and a technology index. And if one scrutinizes the heads that go into GCI, one finds eight heads – openness of the economy to international trade and finance, role of the government budget and regulation, development of financial markets, quality of infrastructure, quality of technology, quality of business management, labor market flexibility and quality of judicial and political institutions. However, these macro policies need to be supplemented with other micro variables captured in BCI through two indices of company operations and strategy and quality of the national business environment. To keep the record complete, one should mention that India performs far better on IMD's WCY, the Indian rank having jumped from 50th (out of 60 countries ranked) in 2003 to 34th in 2004. WCY also has a ranking of regions and Maharashtra's rank has jumped from 44th in 2003 to 38th in 2004.

While one can complain about variables included (or excluded) and the methodology used in GCR or WCY, there ought not to be any great debate about the heads that aid or constrain manufacturing competitiveness. As was mentioned earlier, in this paper, we only concentrate on generic heads. There are indeed sector-specific problems, but we will ignore those. A list of these major heads now follows.

20. Since 1979.

21. Since 1989.

Import Duties

This import duty head has several different strands. First, there is an argument that import duties need to be reduced. This argument is usually advanced when items imported are raw materials and intermediates and not finished goods. The Kelkar Task Force²² recommended a four-tier import duty (that is, for manufactured goods) structure in 2006-07 5% for basic raw materials (coal, ores and concentrates, xylenes), 8% for intermediate goods (capital goods, basic chemicals, metals), 10% for finished goods other than consumer durables and 20% for consumer durables. Some comments are in order about these recommendations. During the Uruguay Round (1986-94), some of India's manufactured goods were exempt from binding commitments. Consumer goods and non-ferrous metals are examples. The Doha Work Programme started in 2001 and was certain to have import duty reduction commitments. When there are no bindings, the GATT/WTO system is unclear about the base on which reduction commitments will apply. The base could have been applied rates. Hence, there was a reluctance to unilaterally reduce duties on consumer goods and this was reflected in the Kelkar Task Force's recommendations. But since those recommendations were submitted, there has been a framework agreement in Geneva on 1st August 2004 and this states that, in the absence of bindings, the base will be twice the applied MFN (most favoured nation) rate in 2001. Indeed, subsequent negotiations suggest that something like this will eventually be accepted. Although there are some exemptions for developing countries, this agreement also provides for zero duties on sectoral basis. There are two arguments that follow. First, while there are arguments for reducing import duties on raw materials and intermediates, there is resistance to reducing duties on finished goods, spiced with fears about an appreciating rupee. Within the WTO system, is there any possibility of import duties higher than 5% on raw materials and intermediates and 10% on finished goods, perhaps 10 years down the line? The answer is probably no. Add to that a plethora of FTAs (free trade agreements) outside the WTO system, which invariably involve manufactured products, with eventual zero duties. Second, and this is a policy question, should one even attempt to have a tiered structure of import duties? When developed countries have such tiered structures, developing countries like India invariably argue that this discourages value addition in developing countries. More importantly, it becomes impossible to decide what is a raw material and what is an intermediate. Consequently, as long as variations across sectors continue, trade facilitation will never improve and customs formalities will never have low transaction costs. These discretionary problems are partly evident in the Union Budgets. Stated differently, the policy problem is the following. Should we standardize or should we attempt to differentiate? And as long as we resist reduction of general import duties, the FTA problem will remain. What do we do about rules of origin and value addition requirements? As long as these issues remain, customs formalities will never be eased.

Second, this is the right place to mention customs formalities, highlighted also by the Kelkar Task Force. For example, there are issues like use of EDI (electronic data interchange) and on-line filing of declarations, self-assessment of Bills of Entry, filing of complete Import General Manifests before arrival of the cargo, establishment of Trade Facilitation Committees, deadlines for processing of documents, payment of customs duties through cheques and licensing and registration systems for Custom House Agents.

Third, there is a level playing field kind of argument that goes beyond mere protectionism. At one level, this is about non-imposition or non-enforcement of standards on imported products, or even about testing and certification requirements. There are also arguments about systemic problems in imposing safeguard or anti-dumping duties. But there is also a different kind of duty argument. While the basic customs duty may be zero, imported products should face duties equivalent to domestic indirect taxes paid by domestic manufacturers. The countervailing duty (CVD) is meant to be precisely this, but is presently only equal to central excise. That ignores State-level sales tax and other local levies. The 2006-07 budget has a provision for an additional CVD of 4%, but 4% is clearly too low. Unfortunately, this reform gets linked with reform of the domestic indirect tax system. Some issues relating to import

22. *Report of the Task Force on Indirect Taxes*, Ministry of Finance and Company Affairs, December 2002.

duties are the following, and in each case, it is discretion that causes the problem in the sector, apart from the general problem of import duties often being too high. These sectoral problems are of course indicative, not exhaustive.

- **Leather industry:** In 2004-05, the government imposed 16% CVD (+2% education cess) on import of capital equipment, moulds and machinery used by the leather industry. By imposing 16% CVD besides educational cess, the government has nullified the promotional efforts made during several years in grooming of this industry. Further, this has come at such a time when this industry is already reeling under the impact of cheap imports from China. The leather industry is known as a labour intensive industry. With large skilled manpower available, there is a huge export potential, in addition to the threat of meeting international competition through imports. This industry needs support in respect of procurement of quality moulds, state of the art capital machinery, test equipment and specific materials not produced in India. The government has excluded several such industries from the imposition of CVD, which were hitherto permitted imports at a concessional rate of customs duty. Can the CVD of 16% imposed on the leather industry be withdrawn in the interests of this industry and the large section of society solely dependent on the leather industry for employment?
- **Consumer electronic products and inputs:** The customs duty on basic raw materials such as plastics, aluminum, copper, steel, lead and zinc is high and varies between 5% and 15%. Since these materials are used in manufacturing, high customs duty increases the cost of inputs, thereby making Indian products globally non-competitive. Customs duties on these basic raw materials should be brought down to 0%. This will lower the cost of inputs, thereby making Indian industry globally competitive.
- **In aluminum ingots,** the present rate of customs duty is unbalanced, tilted highly in favour of primary producers who are taking advantage of higher import duties on aluminum, unilaterally increasing their selling prices, without any corresponding increase in their manufacturing costs. This customs duty should be reduced.
- **Aluminum bars/rods:** The import duty on aluminum bars, rods, profiles, wires etc. (Tariff chapters 76.04 and 76.05) is 10%, whereas on aluminum structural, doors, windows etc. (tariff chapters 76.10) it is 15%. It has been the policy of the Government that the import duty on raw materials should be lower, whereas on finished or semi finished goods, the import duty should be higher to protect small and medium scale industries. Moreover, there are chances of intentional misclassification of goods under chapters 76.04 and 76.10. Unscrupulous importers may bring goods under chapter 76.10, falsely classified under chapter 76.04, since the difference between the two is very nominal, resulting in loss to the Government's exchequer. To avoid such evasion of the duty and also to protect domestic industry of semi-finished or finished goods of aluminum metal, the import duty on goods under chapter 76.10 should be unified with those under 76.04 and 76.05.
- **Die steel related items:** Iron and steel are vital raw materials for many industries. A certain type of special quality steel is required for manufacturing dies and toolings for further manufacture of aluminum or copper extrusions. This alloy steel attracts 10% basic customs duty and 2% educational cess (net of CENVAT), resulting in higher cost of imports. Similarly interchangeable tools, saw blades, files, base metal mountings, specified pumps, spare parts etc. still attract high customs duty. The basic customs duty on such items should be brought down to 5% so that imports of such items can be made at a reasonable cost.
- **Tinplate Prime/Tinplate Steel Prime:** The can-making industry is predominantly concentrated in the small scale sector. It employs more than 100,000 people. The industry consumes about 300,000 tons of tin mill products (tinplate, tin-free steel, black plate etc.) per annum and domestic availability is less than about 50% of industry demand and it also represents 0.5% production of total steel produced in the country. Out of the total 300,000 tons of demand, the industry needs about 60% in tinplate prime and the balance 40% in non-prime (tinplate

waste/waste, secondary and defectives) category. Keeping in mind exports by domestic producers and availability of non-prime in the country, there is a gap of about 75000 tons in the prime category (tinplate, tin-free steel etc.) and 100,000 tons in non-prime category (tinplate waste/waste, defective, secondary etc). Pre budget memorandum suggests that since there is a demand supply gap of about 75000 tons per annum of this material therefore it is essential that the Custom Duty should be minimum as this is an essential packaging material for agro-based industry Customs duty of 5% on raw material tinplate prime/tinfree steel prime should be retained and continue.

- Can making machines: Tin container is a main packaging material for Agro based industry therefore it is important for the domestic Can making industry to modernize and upgrade its technology. Pre budget memorandum suggests that custom duty on can making equipment should be brought down from 15% to 10% in order to help the industry to modernize.
- Wind operated electricity generators: Currently, various components used in the manufacturing of WEGs attracts Customs duties at different rates (5% to 15%). Many of them are also exempted from Customs duty. There is lack of agreement amongst field formations as to the components which constitute wind electricity generators. This has led to inconsistent and sometimes logically absurd interpretation, resulting in harassment and business loss. A holistic definition of wind electricity generator for tax purposes would be welcomed. Pre budget memorandum suggests that in the interest of mainstreaming wind energy generation the Customs duty may be rationalized at 10% for all components and duty exemption may be done away with.
- India has signed Free Trade Agreement (FTA) with Thailand. Some of the consumer electronic products have been included in the Early Harvest Scheme of this Agreement. These products include Colour TV, Colour Picture Tubes (CPT), A/Cs and Refrigerators. With effect from 1st September 2005, customs duty on these products, on imports from Thailand have become 6.25%. It has resulted in incidence of inverted duty for these products. For example, while Colour TV Set can be imported from Thailand at 6.25%, its many inputs attract customs duty of 15%. The Customs duty on Colour TV set would get reduced to 0% on 1st September 2006. India has signed similar agreement with Singapore. Pre budget memorandum suggests that the customs duties on inputs should not be higher than customs duty on finished products.

Some of the policy and tariff related issues relating to hardware industry are:

- An inverted customs duty structure with duties on finished products lower than those on inputs and components has consistently discouraged local manufacture and value addition and encouraged imports. This is also the reason why India, unlike Taiwan, Malaysia and China, has failed to be a part of global supply chain in hardware.
- High prices for local manufacture as compared to international counter parts: primarily due to high Indirect taxation (and its cascading effect) in the range of 40% as against 5-17% in other countries. The level of taxation on complete electronic hardware sector should be 8% CENVAT and 4% state VAT on the complete chain of manufacturing. CST should be abolished for this sector, as it results in negative protection to indigenous industry.
- Custom duty on all the raw materials and inputs required for manufacture of electronics components should be reduced to 0%, as has been done for ITA-1 items.
- All clearances should be made simpler and faster.

Domestic Indirect Taxes

Domestic indirect taxes are often singled out as a major reason why Indian manufacturing is uncompetitive. For instance, the CII-McKinsey report argues that total taxes on manufactured goods are 25 to 30% of the retail price in India, compared to 15% in China and indirect taxes contribute 50% to the difference in retail prices between India and China. That the Indian indirect tax structure is cost-cascading and non-transparent is known. It also imposes significant transaction cum compliance costs on business. But conceptually, one must be clear about the argument that is being advanced. Why do high duties per se render Indian manufacturing uncompetitive? And where? They shouldn't render Indian manufacturing uncompetitive in export markets, because domestic indirect taxes are supposed to be waived or reimbursed. The argument should then be that these waivers and reimbursements don't work satisfactorily. Nor should high domestic duties render manufacturing uncompetitive in the domestic market, because through the CVD route, importers are also supposed to pay these duties. The argument then becomes that the CVD system doesn't work satisfactorily. The argument about high domestic indirect taxes should therefore be more indirect. High compliance costs impact productivity by pre-empting management time. There is bribery and corruption associated with both excise and sales tax. Lower duties would have boosted the domestic market and permitted synergy (exploitation of economies of scale, attracting FDI) between domestic and export markets. The present indirect tax system needs to be further simplified and streamlined. The higher tax revenues have to be realized not through increasing tax rate but through innovative changes in policy, procedures, laws and the dispute settlement mechanism that help overcome the problems associated with the present complex system. Some of the problems associated with the present system are:

- CENVAT credit is available to a manufacturer in respect of inputs and capital goods if the inputs and capital goods are received in the factory of the manufacturer. Pre budget memorandum suggests that appropriate amendments should be made in CENVAT credit rules and the credit in respect of inputs and capital goods used in any ancillary process by the manufacturer of final good should be allowed even if the manufacturing is outside the premises of manufacturer.
- CENVAT credit rules allows distribution of credit services only to a manufacturer if he is distributing to his own units. In other words credit is not available for credit distributed to the job worker units. Pre budget memorandum suggests that in order to encourage small scale manufacturers units, the manufacturer should be allowed to distribute input service credit to job worker unit like in the case of inputs.
- Rule 3(5) of CENVAT Credit Rules, 2004 provides for payment of excise duty on inputs / capital goods equal to the credit availed on them in case they are cleared from the factory 'as such'. In order to comply with this provision, the manufacturer has to keep track of inputs, the rate of duty at the time of their entry into the factory and the value at which they were purchased until such time that the inputs are in stock. Since maintenance of such voluminous data over long periods is prone to human error, very often there are objections by Departmental officers, particularly Audit, and consequent litigation. Pre budget memorandum suggests that Central Excise statues should be amended to allow removal of inputs 'as such' on payment of excise duty at the rate prevailing on the date of removal and the value for purpose of duty determination be the Weighted Average Cost of the inputs as on that date (as per the assessee's books of accounts).
- It should be amended to allow removal of inputs 'as such' on payment of excise duty at the rate prevailing on the date of removal and the value for purpose of duty determination be the Weighted Average Cost of the inputs as on that date (as per the assessee's books of accounts).
- The CENVAT Credit Rules, 2004 provides for availment of CENVAT credit on inputs, service tax and capital goods. Even though 100% CENVAT is allowed on the input at the time of receipt 50% CENVAT credit is only allowed on the capital goods in the year of receipt and the manufacturer has to wait till the next financial year for availing the balance 50% CENVAT credit. There is no logic behind the discrimination with regard to availment of CENVAT credit on

inputs and capital goods. In fact, the assesseees are made to pay 100% excise duty on inputs as well as capital goods. When, 100% CENVAT is allowed on receipt of input there is no reason why the balance 50% CENVAT credit is deferred till the succeeding financial year. The trade and industry is put into severe hardship till the availment of balance 50% CENVAT credit. Pre budget memorandum suggests that CENVAT credit rules should be suitably amended to extend 100% CENVAT credit on capital goods also at par with inputs. After all, the assesseees are paying 100% excise duty and as such CENVAT credit also should be allowed on such excise duty paid by the assesseees.

- As per Rule 4(5)(a) of CENVAT Credit Rules, 2004, a manufacturer who sends Capital goods to the job worker's premises for further processing, etc. has to ensure the return of the same back to his unit within 180 days. However, no such provision exists for the return of jigs, fixtures, moulds & dies which are sent to jobworker's premises for further processing, etc. On most occasions the job-worker utilises other capital goods continuously like jigs, fixtures, moulds & dies. Hence, the provision for return of the other capital goods should be made similar to the provisions relating to jigs, fixtures, moulds and dies. Pre budget memorandum suggests that the provision for return of Capital goods from the job-worker's premises within 180 days should be removed. However, a usage certificate maybe obtained instead from the jobworker for submission to the Department on a yearly basis to keep track of the capital goods lying in the jobworker's premises for a long time. The procedure for submission of a Usage Certificate obtained from the Jobworker annually will enable the Deptt. to keep a track of the capital goods kept in the premises of the job-worker.
- In order to ensure manufacture of quality products, it is essential to carryout the tests of the goods during the course of manufacturing and this requires drawing of samples, time and again, from the various process state of manufacturing. Such samples are consumed during the course of testing itself. Excise duty demands are raised by the jurisdictional authorities one after the other, knowing the fact that such samples are a part of the manufacture activity and also the part of product, value of which has been realized by the assesseees and the payment of excise duty has already been made thereon as applicable. Such instances are even though theoretical in nature and demands raised thereof are likely to be quashed before the appropriate authorities, but issuance of show cause notices are considered to be hardship to the assesseees. Pre budget memorandum suggests that amendment in the law is to be made to the effect that drawing samples and testing thereof will be outside the purview of the definition of manufacture and accordingly is free from the levy of excise duty. If found appropriate, some amount on quantity in line with the production capacity be fixed for such samples, which will be free from levy of excise duty. This will avoid the instances of undue harassment to the assesseees, which has been arising because of issuance of show cause notices on quantity of samples drawn for quality testing etc.
- Input service distributor is an office of the manufacturer/service provider which receives the invoice/challans towards the purchase of input service and issues invoices for the purpose of distributing the credit of service tax paid on the input services. There are manufacturer/service providers having regional offices, branch offices, depots etc., at different places/locations. All these offices and depots are required to maintain records, issue invoices to distribute credit and file return with the Central Excise Department. The procedure appears to be quite complex for a large organization. Thus, the procedure needs to be simplified.
- The Government has been enlarging the scope of service tax. It has added the activity of construction under the service tax net. As a result, it has a bearing on factory shed and building, colony, residential complex etc. The construction costs are very high and further levy of service tax will put the trade and industry or the citizens of the country to financial hardship. Though CENVAT credit is extended for the manufacturer of excisable goods on the service tax paid on construction activity, it affects the other categories who are not in the CENVAT range. Even residential complex or apartments having more than 12 units are required to pay service tax. Pre budget memorandum suggests that tax on constructions activity should be removed.

Reforming indirect taxes is also contingent on reforming direct taxes. In 2004-05, total tax revenue is 10.2% of GDP, if one includes Central taxes alone.²³ If one includes State and local level levies, the figure is more like 15%. Given expenditure commitments and demands on the government, this ratio probably needs to be 3% more as share of GDP. The Kelkar Task Force on implementation of the FRBM (Fiscal Responsibility and Budget Management) Act also argues that fiscal consolidation will primarily have to occur via the revenue route rather than the expenditure contraction route.²⁴ Central tax revenue as a share of GDP has stagnated at around 10% (sometimes even 9%) of GDP since 1990-91. Kelkar's FRBM projections visualize an increase to 12.96% in 2008-09, provided that tax reforms take place. The stagnation in the tax revenue share in the 1990s however masks an increase in the direct tax contribution from 1.9% of GDP in 1990-91 to 4.5% in 2004-05, neutralized by a decline in the indirect tax contribution from 7.9% of GDP in 1990-91 to 5.7% in 2004-05. This is primarily because of a drop in the customs share, but the share of excise has also declined. On welfare grounds, it is valid to argue that taxation through the direct route is preferable to indirect taxation. However, in a developing country like India, notwithstanding direct tax reform, this argument cannot be pushed too far. Indeed, the Kelkar Report's projections have a 6.46% share of direct taxes in GDP in 2008-09 and an indirect tax share of 6.46% also. The simple point is that the indirect tax contribution to GDP must also increase. The argument for reducing multiplicity and increasing transparency should not be confused with a drop in this share. Some of the suggestions developed by the Chamber are:

- The Central Excise Tariff act treats activities like packaging, labelling, relabelling as manufacturing though such process does not constitute manufacturing.
- Presently, there is a CENVAT of 16%, on almost all the consumer electronic products. In addition, State Governments charge Sales Tax/VAT and other taxes. The present high rate of taxes encourages grey market and smuggling. Thus there should be a combined goods and service tax (GST), with service sector taxation integrated into the VAT framework instead of being a tax on turnover. This will be accompanied by a withdrawal of all other taxes like central excise, central sales tax, octroi, State-level sales tax, entry tax, stamp duties, transportation taxes and so on. At present the combined incidence of Central and State levies in India comes to around 35%. In other countries the burden of domestic taxes is around 18%. This is the prime cause of restricting market growth on the one hand and reducing compliance level on the other hand. This also affects the competitiveness of Indian industry.
- There are several types of levies administered by the CBEC other than the CENVAT, viz., SED, AED (Motor Spirit, etc.), NCCD, Education Cess etc. Due to multiplicity of levies separate accounts are required to be maintained by the tax payer which pushes up the cost of compliance. It also gives rise to errors and disputes. Government accounting is facilitated by assessee's paying taxes under different heads but this consumes time and cost for industry. Also exemption notifications applicable to basic duties will not automatically follow for other duties and hence this creates litigation possibilities between assessee's and excise dept. The present indirect tax system needs to be further simplified and streamlined. The higher tax revenues have to be realized not through increasing tax rate but through innovative changes in policy, procedures, laws and the dispute settlement mechanism that help overcome the problems associated with the present complex system.
- Pre Budget memorandum supports Kelkar Committee's recommendations of the Lower Goods and Service Tax at the Central and State level, replacing the CENVAT and State Sales Tax/VAT and other levies. Most of the countries of the world have composite VAT system. The VAT system encourages efficient manufacturing by avoiding cascading of taxes.
- The excise duty rate should converge at 10% from the existing standard CENVAT rate of 16%. This will certainly improve the competitiveness of Indian industry both at domestic as well as global level. Further, similar products should attract same duty
- The concept of special excise duty should be done away with and India must move towards a single duty rate and the incidence of duty and other levies on manufacturers should be reduced.

23. *Economic Survey 2004-05.*

24. *Implementation of the Fiscal Responsibility and Budget Management Act, 2003, Report of the Task Force, July 2004.*

- CST should be abolished from the next financial year itself as it is inconsistent with the VAT Scheme (instead of phasing it out over 2 years as indicated by the Government.)

The limited VAT, limited in the sense that it is only a unification of State-level sales tax, from 1 April 2005, is uncertain. The complete VAT is a long way off. But three points are pertinent. First, when there is a complete VAT, what is likely to be a VAT rate that is revenue neutral? The State VAT proposed has two basic rates of 4% and 12.5%, with an attempt to push several items to the 4% category. 12.5% is not a revenue neutral rate. A revenue neutral rate, with Central and State VAT both included, is likely to be more like 20%. Indeed, the Kelkar standard rate is 12% for Central VAT and 8% for State-level VAT. Consequently, a figure like the 15% cited for China, is probably impossible. Second, even for something like 20% to work, there has to be an end to discretion. The budget for 2005-06 is a case in point. If there is a standardized rate of 16% for excise, there is a valid argument that cars and aerated soft drinks should also be at this level. But there is an equally valid argument that no items should be below 16%. Why, for instance, should excise be 2% on branded jewellery and 8% on imitation jewellery?

Those who push for indirect tax reform should therefore simultaneously argue for standardization and an end to discretionary treatment. Third, and this is an extension of the second argument, indirect tax reform will work only if all exemptions are terminated product-specific exemptions, SSI exemptions, location-based exemptions. People often quote the CII-McKinsey report, which argues that indirect taxes in India are unnecessarily high. What they sometimes fail to quote is that this report also argues against removal of exemptions. With effect from 1st April, 2005, VAT has been implemented by majority of States. However, some States have still not adopted the VAT as a result, two different systems of tax on sales are being implemented in the country. This has created a number of practical difficulties for the Manufacturers for maintenance of records etc. and is creating a lot of hardship. All non compliant States should be brought under the VAT System.

There is a need to bring in uniformity in the tax rates under VAT system. The objective of VAT is to make India a common market and to improve the competitiveness of the Indian industry. Lack of uniformity in VAT rates bring arbitrage opportunities. The states are still continuing with taxes like entry tax, special entry tax, octroi etc. Under VAT system all taxes, levies and cess should be integrated.

There is lack of uniformity for giving credit tax on capital goods under the VAT system. The system for giving credit on capital goods should be the same which is prevalent under excise act. The quick credit in the system will reduce the working capital requirements and hence the interest cost and improve competitiveness.

Export Incentives/Export Subsidies

There is a conceptual difference between export incentives and export subsidies. Export subsidies involve differential treatment to exports as compared to sales in the domestic market and are in general WTO-incompatible, although there are some exemptions for India. Export incentives are WTO-compatible, as they involve reimbursements (DEPB and duty drawback) or waivers (advance licences) for duties paid in exported products. Export Incentives are extended by the DGFT against the exports made to foreign countries at the scheduled rate of credit fixed by the Ministry of Commerce. In most of the States, the State governments levy sales tax on transfer of these documents. The imposition of tax on DEPB, Advance Licence & DFRC reduces the quantum of Export Incentive and makes the final product unviable in the foreign market.

As per the pre budget memorandum export subsidies should not be taken as additional consideration under excise laws. Problems arise because of the present system of averaging across units in granting waivers. Legitimate export incentives thus become labeled as unwarranted export incentives and are exposed to countervailing duty impositions. This has already arisen in the case of DEPB, but is equally applicable to duty drawback also. In principle, implementation would be easier if one switched over completely to an advance license system. However, given that there are several small exporters, this might not be feasible. Nor should one forget that export procedures continue to be cumbersome because of procedures connected with export incentives/subsidies. If these are not availed of, procedures have become reasonably simple. Implementation of both DEPB and duty drawback will become simpler if there is a complete VAT system. In the absence of a complete VAT, the rates provide for some remission of domestic taxes other than excise and import duties, and because the system is non-transparent, the link becomes difficult to establish. Beyond this conceptual problem, there are also issues connected with procedures, such as delays in reimbursements.

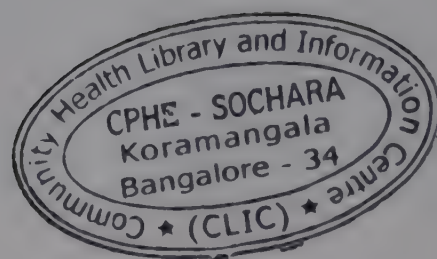
Drawback rates in respect of goods taken into use after importation are governed by M.F. (DR) Notification 19-Cus dated 6.2.1965 as amended. The Notification provides for a graded drawback varying in six monthly intervals. Principle of computation of drawback on quarterly basis is recognized in customs law in case of re-export after personal use, computation of values for import of second hand machines etc. The basis is however different for re-export after industrial use which is on six monthly intervals. A possible option is given in the following table.

Existing Drawback Table

Suggested Drawback

Sl. No	Period of retention in India (length of period between import and re-export)	Percentage of import duty to be paid as Drawback	Sl. No	Period of retention in India (length of period between import and re-export)	Percentage of import duty to be paid as Drawback
1	Not more than 6 months	85%	1	Not more than 3 months	93%
2	> 6 months – 12 months	70%	2	> 3 months – 6 months	85%
3	> 12 months – 18 months	60%	3	> 6 months- 9 months	78%
4	> 18 months – 24 months	50%	4	> 9 months- 12 months	70%
5	> 24 months – 30 months	40%	5	> 12 months- 15 months	65%
6	> 30 months – 36 months	30%	6	> 15 months- 18 months	60%
7	> 36 months	NIL	7	> 18 months- 21 months	55%
			8	> 21 months- 24 months	50%
			9	> 24 months- 27 months	45%
			10	> 27 months- 30 months	40%
			11	> 30 months- 33 months	35%
			12	> 33 months- 36 months	30%
			13	> 36 months	NIL

There is yet another conceptual problem for EOUs, SEZs and AEZs. These had a role when there wasn't general liberalization. But with liberalization across the board, liberalization in selected enclaves has become somewhat irrelevant. If customs duties have come down and are going to drop further, what is the added attraction of these schemes, especially if there are going to be restrictions on sales in the domestic tariff area (DTA)? Quite often, debates about SEZs/AEZs vis-à-vis EOUs are about equal treatment in sales to the DTA and about concessional customs duties on such DTA sales. With import duties declining, surely one could argue that there should be no restrictions on DTA sales. This might as well be completely freed up. Another argument advanced in favour of SEZs/AEZs is that they involve simplified procedures. That is also a perverse argument. Procedures should be simplified everywhere, not just in SEZs/AEZs. An argument can also be advanced that SEZs/AEZs will have simplified labour laws. We will talk about labour laws later, but given Article 14 of the Constitution, it is doubtful that such an argument can be pushed very hard. This really leaves better infrastructure development in SEZs/AEZs. Stated differently, the argument is no different from the idea of pushing growth in clusters and we will return to this point later.



RS-170 pub

12847

FDI and Procedures

Foreign investments mean both foreign portfolio investments and foreign direct investments (FDI) and Economic Survey 2004-05 emphasizes FDI in its issues and priorities segment. In a classic sense, FDI has been regarded as desirable because it contributes towards bridging two gaps the foreign exchange gap and the savings/investment gap. Neither of these is that relevant for India any more, certainly not the first. However, FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. This efficiency contribution of FDI is much more important. There was a slight problem with Indian FDI definitions, since these didn't conform to IMF guidelines. With the revised definition, FDI inflow figures are 3.40 billion US dollars in 2001, 3.45 billion in 2002 and 4.27 billion in 2004, there being a gap between approvals and inflows. This is a far cry from China's 53.51 billion in 2003 and the target of annual FDI inflows of 10 billion a year. UNCTAD now has a FDI performance index ranking and a FDI potential index ranking. In 2001-03, India's FDI performance index ranking was 114th out of 140 countries.²⁵ In a large country like India, FDI as a share of GDP will never be very high. And barring certain sectors, FDI as a share of total investments will also not be very high. But there is no denying that India has under-performed.

Why has India under-performed? The reasons are obvious enough. First, FDI in manufacturing is now completely open, with Press Note No. 18 having been scrapped for new entrants, although there are some restrictions on mergers and acquisitions. Second, the bulk of cross-border FDI inflows are in the services sector and the services sector is still subject to equity caps, not everything having been placed on automatic approval. Third, policies in the infrastructure sector are often not in place. Fourth, there are procedural problems at all three levels of an enterprise's functioning entry, functioning and exit, although foreign investors often tend to focus on the first. This is not purely a foreign investor issue. Courtesy national treatment, equally cumbersome procedures are also foisted on domestic investors. The expression transaction costs is sometimes used and such an expression also subsumes under it costs associated with inadequate infrastructure. We will talk about infrastructure later.

For our purposes, transaction costs mean procedural costs alone. There is no real quantification of the extra cost disadvantage that Indian manufacturing faces because of transaction costs. There are some figures of around 20%, but those include infrastructure costs also. However, a recent World Bank report benchmarks India's transaction costs with some other countries in the world.²⁶ It takes 89 days to start a business in India, compared to 41 days in China. It takes 67 days to register property in India, compared to 32 days in China. It takes 425 days to enforce contracts in India, compared to 241 days in China. It takes 10 years to complete insolvency proceedings in India, compared to 2.4 years in China. One should remember that many, though not all, of these procedures are at the State government level. Land, labour, water, electricity, environment are examples. This also explains why conversion ratios (percentage of approvals converted to inflows) vary widely across States. Maharashtra, Delhi, Tamil Nadu, Karnataka, Gujarat account for the bulk of FDI approvals under the automatic route.

Interest Rates

High interest rates and availability of credit are often cited as problems, as indeed they are. But one must be careful to separate out the price effect from a non-availability of credit problem. The prime lending rate (PLR) is around 10.25% now, compared to a deposit rate of around 5.5%. Household financial savings are 11.4% of GDP. If combined Central and State-level deficits are in excess of 10% of GDP, not to speak of artificially high guaranteed rates of return on small savings, there will be upward pressures on interest rates. Whichever index one uses to measure inflation, annual inflation is around 6% now. With a PLR of 10.25%, this means a real rate of interest of 4.25%. In a capital scarce country, real interest rates will never be as low as global interest rates, although this is qualified by the harmonization

25. *World Investment Report 2004, The Shift Towards Services*, UNCTAD, 2004.

26. *Doing Business in 2005*, World Bank, IFC and Oxford University Press.

that has taken place between global and domestic interest rates. Some parts of the Indian corporate sector are now allowed to borrow globally, though not all. Why are real interest rates still so high? Other than deficits and small savings, one needs to highlight the interest spreads of banks. This masks inefficiencies in the banking system. But it also incorporates elements of priority-sector lending (at pre-determined interest rates) and significant non-performing assets (NPAs). On the latter, it is necessary to recognize that competition means free entry as well as exit. And there is a tendency to prevent exit, notwithstanding the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act. This locks up capital in unproductive sectors and units. There are also special problems with exit in the SSI sector.

Beyond the cost of credit issue, there are problems with availability of capital, not just bank finance, but also through the stock market, and this includes venture capital. As a general proposition, too much capital flows to relatively larger units. There are collateral problems in the SSI sector. But there is also a mindset issue. Even if the risk premiums are not higher, and this need not always be the case, the administrative costs of delivering credit to the SSI sector will be higher. Ipso facto, interest rates will be higher, regardless of the euphoria about micro-finance and micro-credit. The argument that credit to the SSI sector will have to be at a few percentage points below PLR then seems to be counter-productive.

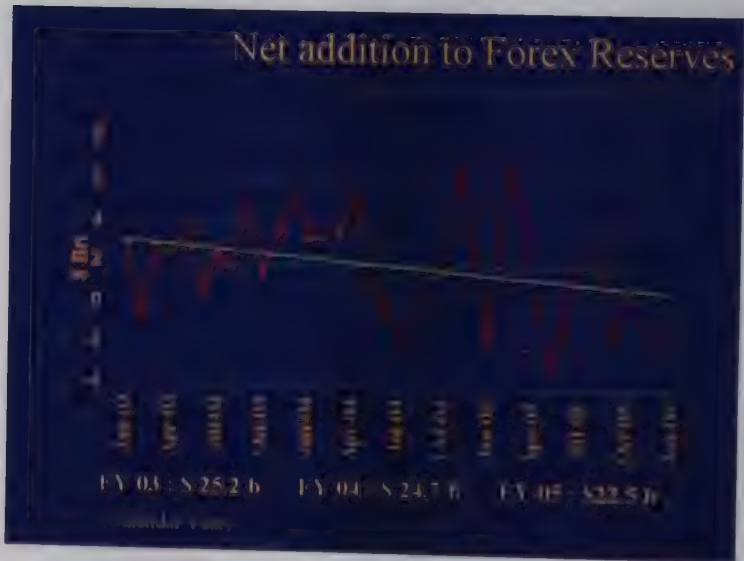
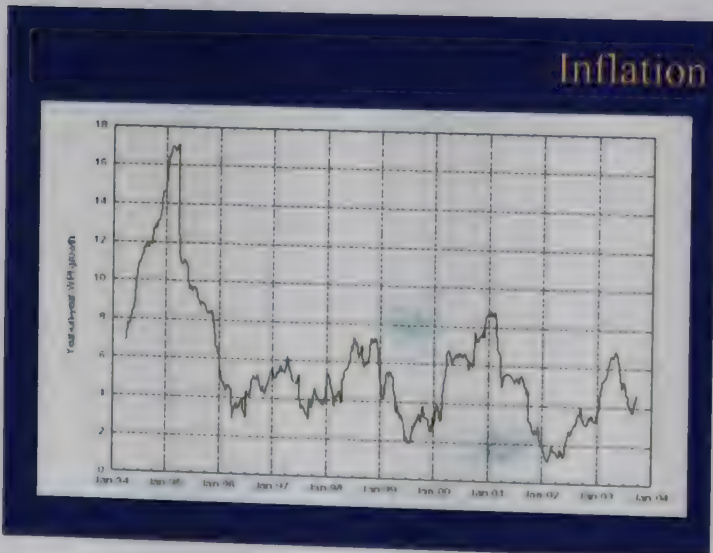
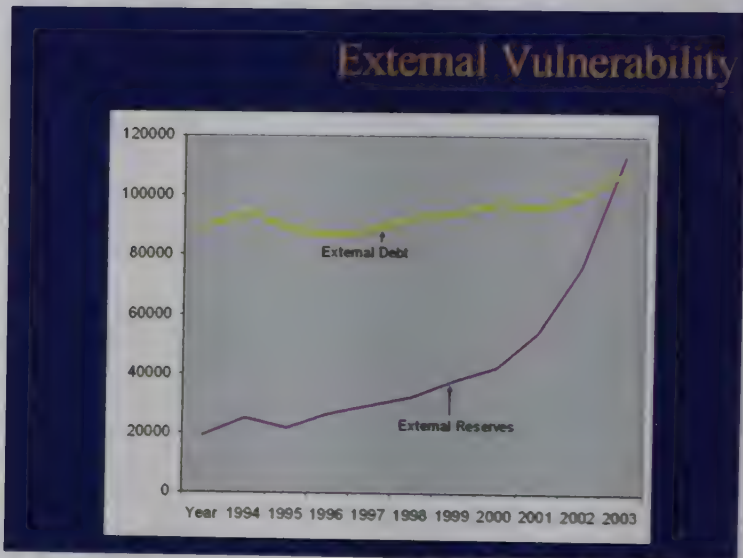
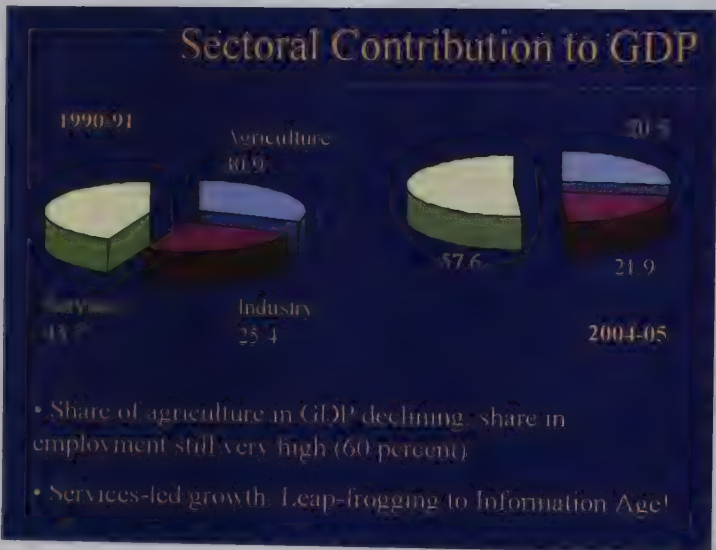
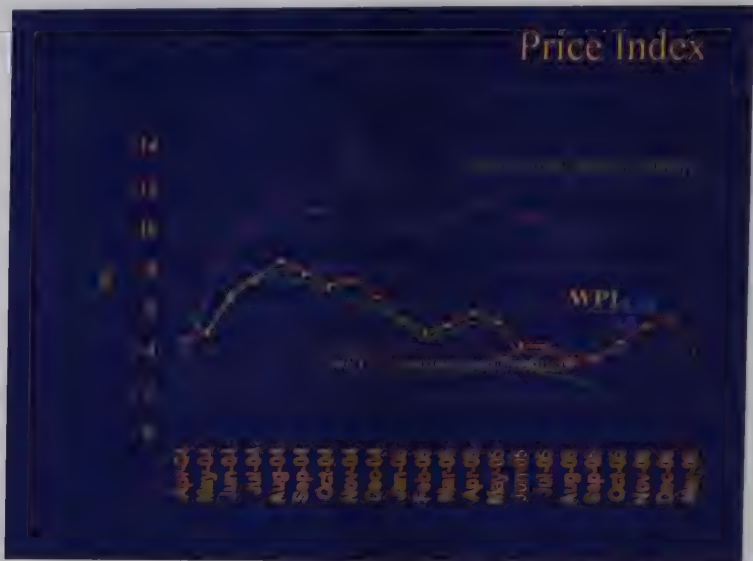
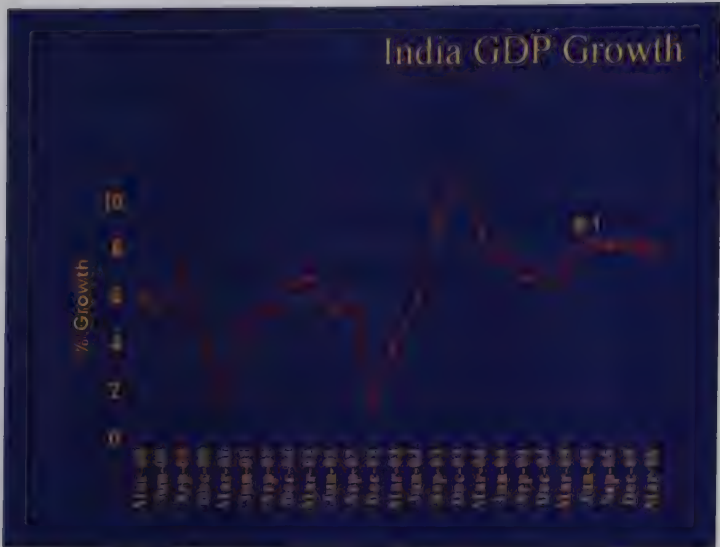
Infrastructure

Infrastructure means several different things and there can be no quarrel with the proposition that inadequate infrastructure renders Indian manufacturing uncompetitive. Economic Survey 2004-05 lists power, telecom, posts, roads, ports (airports and seaports), civil aviation, railways, urban infrastructure and legal infrastructure as infrastructure. As a generalization, the infrastructure area where there have been visible improvements is telecom, with roads perhaps following as a somewhat distant second. The contours of unbundling, user charges and regulatory agencies are known. The issue is simply one of getting infrastructure reforms implemented and some areas of physical infrastructure are State subjects. From the manufacturing perspective, perhaps the most important infrastructure areas are power, ports and railways, followed by roads. The issues are twofold. First, given scarce government resources, where are these best deployed? Second, again given scarce government resources, what is the scope for private sector involvement?

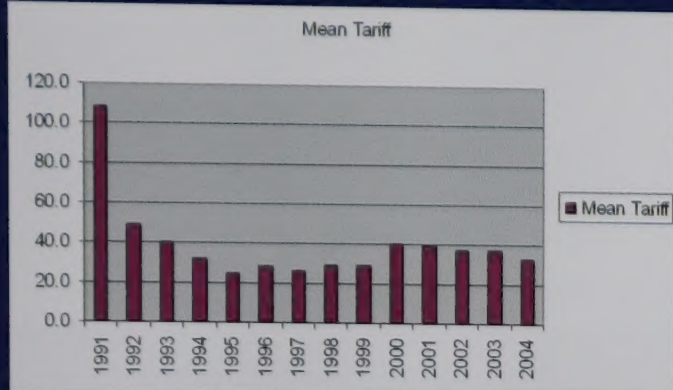
The onus for everything mentioned above has implicitly been on the government. But that is only part of the answer. Access to technology, larger investments that drive exploitation of economies of scale and scope, accessing market information and so on are in the private domain, although there is often a tendency to expect the government to provide or subsidize these efforts. But given fiscal and other limitations, there are constraints on what the government can effectively do. And some services, like some areas of physical infrastructure (water treatment is an instance); marketing information or skills development, are not even global public goods. One is not even certain that they are local public goods. They are probably collective private goods. In other words, once policy-induced entry barriers are removed, it is up to the private sector to deliver these services collectively, with appropriate user charges imposed.

There is a great responsibility on the industrial and manufacturing sector where GDP growth is concerned. The historical trend for growth in the primary sector has never been more than 3%. This secondary sector or industry includes components of mining and quarrying, manufacturing, electricity, gas and water supply and construction, with manufacturing contributing the bulk of 79.36%. An average growth of 6% in the other three components requires manufacturing to grow at 12.26%. Construction may perform better, as it often has in the decade of the 1990s and subsequently. To that extent, the burden on manufacturing, in terms of that growth target of 9%, eases. But on the other hand, the primary sector may not chip in with 4% growth. Therefore, a 12% target for manufacturing ought to be the target growth.

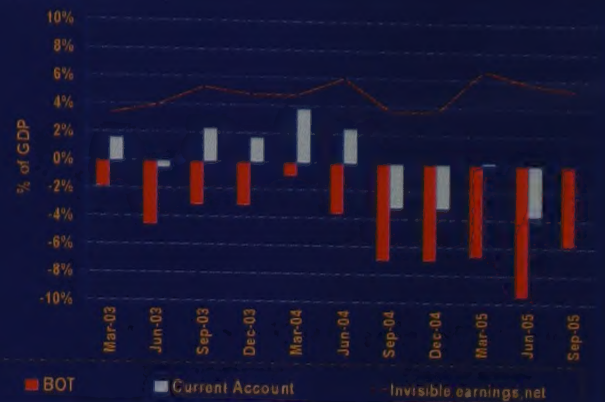
Selected Economic Indicators



Opening of the economy



Current-Account Deficit



Country profile of tariff structure

Country	Applied Tariff (in percentage terms)		
	All	Agri	Mfg.
India	29.00	36.90	27.70
Bangladesh	19.50	21.70	19.20
China	12.40	19.20	11.30
Pakistan	17.10	20.40	16.60
Malaysia	7.30	2.10	8.10
Indonesia	6.90	8.20	6.70
Thailand	16.10	29.00	14.20

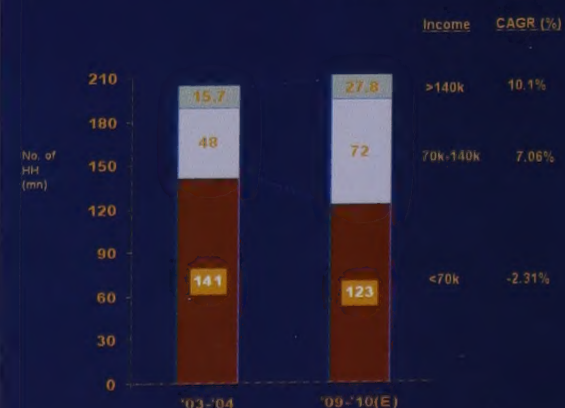
Aging in Selected Countries

	Median Age (Years)			Old Age Dependency Ratio		
	2000	2025	2050	2000	2025	2050
United States	35.5	39.3	40.7	18.6	29.3	34.9
Canada	36.9	42.9	44.0	18.5	32.6	40.9
Mexico	23.3	32.5	39.5	7.6	13.8	30.0
France	37.6	43.3	45.2	24.5	36.2	46.7
Germany	40.1	48.5	50.9	24.1	39.0	54.7
Italy	40.2	50.7	54.1	26.7	40.6	68.1
Spain	37.7	49.2	55.2	24.8	36.1	73.8
United Kingdom	37.7	44.5	47.4	24.1	34.8	47.3
Russia	36.8	43.8	50.0	18.0	27.6	47.1
Japan	41.2	50.0	53.1	25.2	49.0	71.3
China	30.0	39.0	43.8	10.0	19.4	37.2
India	23.7	31.3	38.0	8.1	12.1	22.6

Merchandise Trade

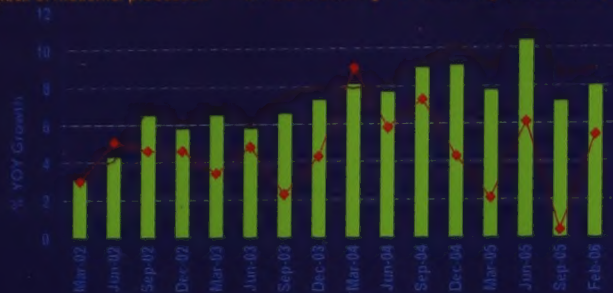


Increasing Target Market



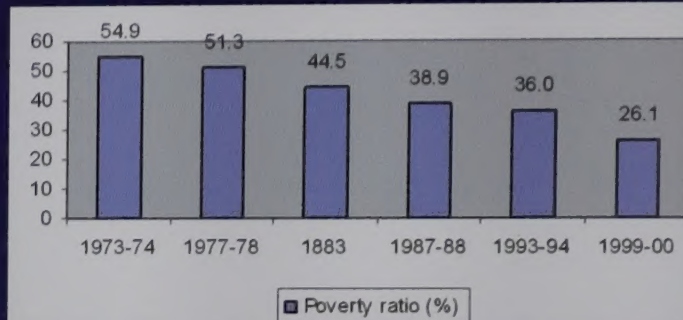
Index of Industrial Production

Index of industrial production: IIP: Manufacturing IIP: Mining and Electricity



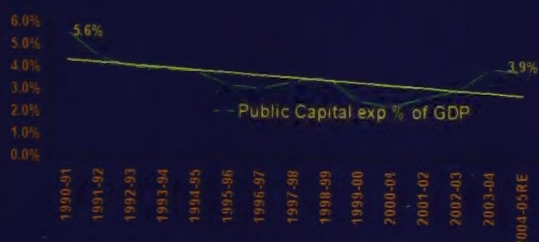
% Growth YoY	IIP	Mining	Mfg	Elec
2004-05	8.3	5.1	8.7	7.7
2005-06	8.8	1.3	9.9	4.8

Poverty trend



Poverty (2004-2005): 24 per cent

Declining public investment in infrastructure



Source : Economy Survey

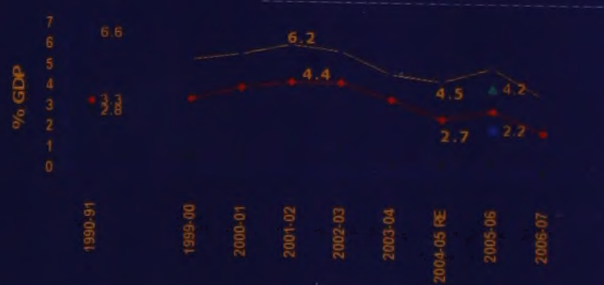
High Military Expenditure

Expenditure

Latin America	1.24
East Asia and Pacific	2.19
South Asia (India)	2.41

Expenditure as a percentage of GDP

Fiscal Stress



Fiscal Def Revenue Def
Primary Deficit Fiscal Deficit Target 05-06
Revenue Deficit target 05-06

PHDCCI Monthly Bulletin

The PHD Chamber Bulletin is a monthly publication, recognized not only as of trade, industry and economy of corporate India, but also as a very useful medium of information. The bulletin, besides containing regular Chamber activities, also contains articles from select experts from various fields, industry updates and special features on topical issues.

Every month, the 2000 copies of the Bulletin are circulated amongst 1600 Industries and senior officials in the Government of India, Ministries, State Governments and the Chambers of Commerce and Associations in over fifty countries, besides all our members. The Bulletin also enjoys readership in the Diplomatic Missions and Embassies in New Delhi and is subscribed by libraries of some of the noted Institutes and Universities of the country.

PHDCCI Bulletin Revised Advertisement Tariffs

Advertisement Tariff Per Issue		Special Offers	
		For one Year	For 5 years
Back cover	22500	183333	550000
Inside covers	15000	100000	300000
Full page	7500	66667	200000
Half page	5000	50000	150000
Quarter page	3000	35000	100000
Front cover - strip	15000	250000	750000

PHDCCI is a private non-profit organization devoted to industrial growth, independent research and policy solutions. It is an industry led and industry managed organization, playing a proactive role in North India's development process. PHDCCI analyzes current and emerging issues and produced new ideas that take the reform process forward. PHDCCI members provide the highest quality research, policy recommendations, and analysis on the full range of public policy issues. Research at PHDCCI is conducted to inform the public debate. Its office bearers, the President and the Vice President, are leading industry leaders who devote more than two years of their time to guide the Secretariat in its activities.

PHDCCI traces its beginnings to 1905, when a group of leading reformers founded the first business chamber in North India, a private organization devoted to analyzing public policy issues at the national level. PHDCCI is financed largely by its members, corporations, and private individuals. The Chambers funds are devoted to carrying out its research and educational activities. PHDCCI works to create and sustain an environment conducive to the growth of industry in the eleven states of North India, partnering Industry and government through advisory and consultative processes.

PHDCCI is the leading business support organization in this area of Northern India that contributes to more than 40% of India's exports and is among the fastest growing industrial areas in the county. It is guided by its defining principles of ethical business methods, corporate governance and social responsibility. The Chamber works through two independent foundations, the PHDCCI Rural Development Foundation and the PHDCCI Family Welfare Foundation, in the areas of education, health care, environment and energy to foster sustainable development in the country.

In it's history of a little more than 100 years, PHDCCI has emerged as North India's premier business association, with a direct membership of over 1500 organizations form the private as well as public sectors, including SMEs and MNCs and reaches more than 60000 organizations through its 140 Association members and 175 Professional members covering national and regional sectoral associations. It provides a broad range of services to its members helping them enhance productivity; improve efficiency and network with domestic and foreign partners. With 6 offices in India and institutional partnerships with a large number of counterpart organization in various countries, PHDCCI serves as a reference point for Indian industry and the international business community.



PHDCCI

PHD House, 4/2 Siri Institutional Area, August Kranti Marg, New Delhi-16
Phone : 91-11-26863801-04 Fax : 91-11-26855450
Website : www.phdcci.in